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SUBJECT: Austrian Recession Deep, Budget Deficit
Wide

REF: (A) VIENNA 0365; (B) VIENNA 0329;
(C) VIENNA 0296; (D) 08 VIENNA 1889

¶1. SUMMARY: Austria's export-oriented economy has plunged into a much deeper recession than expected but will still outperform Germany. Leading Austrian forecasters have drastically downgraded their GDP growth forecasts for 2009 (now projected to contract by 2.2-2.7%). The recession is severe and persistent and affects all sectors of the economy: exports and investments are shrinking, with private consumption growth as a meager stabilizer. For 2010, economic institutes project stagnation. Inflation is not on the horizon. Unemployment will rise to 5.0-5.3% in 2009 and 5.8-6.1% in 2010. The budget deficit will rise drastically from 0.3% of GDP in 2008 to 3.5-4.0% in 2009/2010. END SUMMARY.

Disastrous Fourth Quarter, Now Sharp Recession
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¶2. Like much of Europe, the highly export-oriented Austrian economy plunged into recession in the fourth quarter of 2008 and has performed much worse than expected (ref B). The Austrian Institute for Economic Research (WIFO) and the Institute for Advanced Studies (IHS) on March 27 presented drastically downscaled GDP projections for 2009 and ¶2010. The institutes had projected quasi-stagnation (0.1-0.5%) and now foresee contraction of 2.2-2.7%. Austria's economy is still expected to outperform the Eurozone (projected to shrink between 3-3.5%) in ¶2009.

¶3. Austria's economy has been hit by the recession in the U.S., Japan, the EU and now CESEE economies (ref C). Recession was late to hit Austria and was still gaining negative momentum in the first quarter, with a sharp drop in both exports and investment. A meager positive contribution will come from private consumption, supported by a real 3.6% increase in per capita after tax incomes due to last year's wage increases, declining inflation and the upcoming income tax cut. The recession is deep and affects all sectors of the economy, particularly industrial production. Economists expect a very bad first half with a nadir in the summer.

¶4. The Austrian economy should stabilize by the end of the year given the size of GoA stimulus measures which together with the upcoming income tax cut (retroactive to January 1, 2009) equal 1.5% of GDP

and are larger than in most European economies. An inflection point will come in the second quarter, when the GoA stimulus packages and income tax cut should show first effects. Both WIFO Director Karl Aiginger and IHS Director Bernhard Felderer advocated speeding up implementation of the stimulus. Inflation will be no problem in 2009/2010.

Stagnation in 2010

¶5. After stabilizing in the second half of 2009, the economy will basically stagnate in 2010. The institutes cut their growth expectations for 2010 and now expect modest growth of 0.4-0.5%, instead of the 0.9-1.3% growth projected three months ago.

Downward Risks Predominate

¶6. While he has been overly optimistic until now, Aiginger expressed confidence that the new forecast will hold -- unless there is another dramatic deterioration of the international environment. Felderer said the IHS is less optimistic and that further revisions would most likely be downward. Felderer did acknowledge signs of cautious optimism in financial markets (ref A).

Assumptions for Growth Forecasts

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¶7. The institutes based their revised 2009/2010 forecasts on the following assumptions:

- U.S. economic growth of -2.7% to -3.0% in 2009 and 0.5-1.0% in 2010;
- Eurozone growth of -3.0% to -3.5% in 2009 and 0.0-0.5% in 2010;
- EU-27 growth of -3.0% to -3.3% in 2009 and 0.0-0.5% in 2010;
- German growth of -3.5 to -4.3% in 2009 and 0.0-0.5% in 2010;
- oil prices of \$44-45 per barrel in 2009 and \$55-60 in 2010; and
- USD/EUR exchange rate of 0.77-0.80 in both 2009 and 2010.

¶8. Like the IMF and World Bank, Austrian forecasters see world economic growth as negative (minus 1.0%) in 2009 for the first time since WWII. Aiginger expects the U.S. economy to recover faster and do better than Europe in both 2009 and 2010 due to the massive USG fiscal stimulus and aggressive monetary policy. Felderer opined that Europe should not copy everything the U.S. does. Both Aiginger and Felderer criticized international rating agencies for irresponsible messaging, which has caused the GoA (despite its strong economic data) to pay higher interest rates for bond issues on international markets than other European countries. Austria's mere vicinity to CESEE should not trigger higher interest spreads, they said.

Labor Market Downturn, Strong Rise in Unemployment

¶9. The recession will cause a German-style downturn in Austria's labor market. After record employment growth of 2.4% in 2008 and a resulting low unemployment rate (about 3.5%), Austria's labor market in 2009 will see shrinking employment (-1.1%) and a parallel rise in the number of unemployed by a quarter or at least 53,000 for an annual average of

265,000 in 2009 and close to 300,000 in 2010. Thus, the institutes now project an unemployment rate of 5-5.3% in 2009 and of 5.8-6.1% in 2010, with not much relief expected in 2011. In addition, Austria will have some 40,000 industrial workers on reduced working hours and 50,000 in training. Since Austria's unemployment does not fall unless economic growth tops 2.5%, economists see unemployment as the most pressing economic policy issue in Austria; without decisive measures, Austria could end up with "sawtooth" rises in unemployment as in post-reunification Germany.

Budget Deficit Close to 4% of GDP

¶10. Finance Minister Josef Proell has publicly abandoned the GoA budget deficit target for 2009 (2.5% of GDP). No new government projection is available. After a lower than expected total public sector deficit (0.3%/GDP) in 2008, WIFO and IHS now project a deficit of 3.3-3.5% in 2009 and 4% in ¶2010. Aiginger and Felderer endorsed GoA stabilization measures and the resulting higher budget deficit, but advocated moving now to reduce the deficit as growth returns, for instance by implementing stalled administrative reforms. FinMin Proell will submit the 2009 federal government budget on April 21; final approval by Parliament is scheduled for May 29.

¶10. Statistical Annex

Projections of
Forecasted Austrian Economic Indicators
(percent change from previous year,
unless otherwise stated)

	WIFO 2009	IHS 2009	WIFO 2010	IHS 2010
Real terms:				
GDP	-2.2	-2.7	0.5	0.4

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Manufacturing	-5.5	n/a	0.5	n/a
Private consumption	0.4	0.4	0.8	0.4
Public consumption	0.5	0.3	1.0	0.0
Investment	-5.9	-6.3	-0.6	-1.9
Exports of goods	-7.0	-9.5	0.5	2.8
Imports of goods	-5.0	-6.7	0.3	1.5

Nominal EUR billion:				
GDP	280.1	278.7	283.9	282.5

Other Indices:				
GDP deflator	1.4	1.5	0.8	0.9
Consumer prices	0.6	0.9	1.1	1.4
Unemployment rate	5.0	5.3	5.8	6.1
Current account (in percent of GDP)	1.6	n/a	1.3	n/a
Exchange rate (US\$/EUR)	0.80	0.77	0.80	0.77

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